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**MEMORANDUM**



TO: THE COMMISSION

FROM: Utilities Division

DATE: December 21, 2000

RE: SOUTHWEST GAS CORPORATION – FILING FOR APPROVAL OF AN AMENDMENT TO THE SPECIAL GAS PROCUREMENT AGREEMENT WITH TUCSON ELECTRIC POWER COMPANY (DOCKET NO. G-01551A-00-0963)

On May 22, 1998, in Decision No. 60914, the Commission approved the initial procurement agreement between TEP and Southwest Gas. Service under Schedule G-30 is available to customers who can establish that bypass of Southwest is economically, operationally, and physically feasible and imminent.

On October 24, 2000, TEP filed a Statement of Dissatisfaction or In the Alternative, Formal Complaint, against Southwest, alleging that Southwest was overcharging TEP for interstate pipeline capacity as part of the procurement agreement. On October 26, 2000, Southwest filed an Answer and a Request for Order Compelling TEP to Comply with Commission Regulations Pertaining to the Timely Payment of Bills for Natural Gas Service Pending a Final Resolution on the Merits. On October 26, 2000, a Procedural Order was issued, setting the matter for hearing on January 25, 2001. In recent months, Southwest and TEP have held discussions regarding this dispute and as a result of these discussions they have reached a mutually acceptable settlement of their differences.

On November 22, 2000, Southwest Gas Corporation ("Southwest") filed for Commission approval of a Special Gas Procurement Agreement (procurement agreement) under Special Condition Three of Schedule G-30, Optional Gas Service, with Tucson Electric Power Company ("TEP"). On December 15, 2000, the Commission suspended this filing until February 18, 2001, to provide Staff with time to analyze the filing. Southwest's filing is a result of a resolution of the dispute between Southwest and TEP regarding the monthly pipeline capacity charges that TEP pays to Southwest under the procurement agreement. Although it is not necessary for Southwest to directly file for Commission approval of the settlement, Southwest felt it was necessary to file for Commission approval of the revised special gas procurement agreement because of the impact on the PGA bank balance of any changes in the capacity charge calculation, as well as the proposed change in the contract to reflect the agreed upon method of calculating the capacity charge.

The original procurement agreement contained language indicating that the capacity charge to be paid by TEP to Southwest would be "determined monthly via a calculated methodology agreed to by the Customer and the Utility". At the time, Southwest had indicated to Staff that it had agreed with TEP on the calculation methodology and that the resulting charge would be reflective of current market prices.

As with all special gas procurement contracts, the upstream pipeline capacity charges collected from the customer under this contract are credited to the purchased gas adjustor ("PGA") bank balance, thereby benefiting Southwest's ratepayers. If a resolution of the dispute between TEP and Southwest changed the way the pipeline capacity charges for TEP are calculated, that would impact the size of the credits to the PGA bank balance.

The dispute between Southwest and TEP involved a number of issues, including how the amount of natural gas supplied to TEP out of different supply basins impacts the capacity charge calculation and whether the capacity charge is capped at 100 percent of the Federal Energy Regulatory Commission ("FERC") approved El Paso firm transportation reservation rates.

Southwest's filing amends the capacity charge calculation in the special gas procurement agreement to reflect the terms agreed to in the settlement agreement. Supplies for TEP from the Anadarko and Permian supply basins would be assessed a capacity charge based upon the difference between the Natural Gas Week bid week indices for the Permian basin and the California border. Supplies for TEP from the San Juan Basin would be assessed a capacity charge based upon the difference between the Natural Gas Week bid week indices for the San Juan basin and the California border. Additionally, the capacity charge will be capped at 100 percent of the FERC approved El Paso firm transportation reservation rates.

Under the settlement agreement and proposed revision to the special gas procurement agreement, this methodology for calculating the capacity charge would be applied to TEP beginning in October 2000. The settlement agreement contains negotiated numbers for the capacity charge for August and September 2000 and prior to August 2000 TEP agreed to the capacity charges as previously calculated by Southwest.

The special gas procurement agreement continues on a year to year basis. Either party is able to terminate the agreement with at least 90 days notice before the anniversary date of this agreement. The agreement covers TEP's generating facilities at Irvington, Demoss-Petrie, and North Loop. TEP's facilities are located in close proximity to an El Paso Natural Gas Company (El Paso) pipeline, and the Irvington facility, which is TEP's main facility included in this agreement, is directly adjacent to El Paso's pipeline. Therefore, TEP can totally bypass Southwest. The procurement agreement includes a commitment by TEP to take all of its natural gas requirements (beyond landfill gas) from Southwest.

The specific charges for serving TEP were provided to Staff under a confidentiality agreement. Staff has reviewed the charges included in the proposed procurement agreement and believes that the revenues Southwest receives should cover its cost of serving TEP. However, if conditions change in the gas market it is theoretically possible that Southwest could experience a conditions change in the gas market it is theoretically possible that Southwest could experience a negative margin on this procurement agreement.

Given current circumstances, the proposed capacity charge calculation methodology appears to be an equitable balance between compensating Southwest ratepayers for use of interstate capacity and serving TEP. Additionally, the treatment of past capacity charges, as proposed in the settlement agreement, appears to reflect a reasonable level of compensation to Southwest's core customers for the use of Southwest's interstate capacity by TEP. Therefore, Staff recommends approval of this filing. Further, Staff recommends that any negative margin resulting from this agreement not be recovered from other ratepayers in any future proceeding.

Deborah R. Scott
Director
Utilities Division

DRS:BGG:lhm\JMA

ORIGINATOR: Robert Gray

**BEFORE THE ARIZONA CORPORATION COMMISSION**

CARL J. KUNASEK
Chairman
JIM IRVIN
Commissioner
WILLIAM A. MUNDELL
Commissioner

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| IN THE MATTER OF THE APPLICATION OF SOUTHWEST GAS CORPORATION - FILING FOR APPROVAL OF AN AMENDED SPECIAL GAS PROCUREMENT AGREEMENT WITH TUCSON ELECTRIC POWER COMPANY | DOCKET NO. G-01551A-00-0963<br>DECISION NO.__________<br>ORDER |

Open Meeting
January 9 and 10, 2001
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. On May 22, 1998, in Decision No. 60914, the Commission approved the initial procurement agreement between TEP and Southwest.

2. Service under Schedule G-30 is available to customers who can establish that bypass of Southwest is economically, operationally, and physically feasible and imminent. Southwest Gas Corporation (Southwest) is engaged in providing natural gas within portions of Arizona, pursuant to authority granted by the Arizona Corporation Commission.

3. On October 24, 2000, TEP filed a Statement of Dissatisfaction or In the Alternative, Formal Complaint, against Southwest, alleging that Southwest was overcharging TEP for interstate pipeline capacity as part of the procurement agreement. On October 26, 2000, Southwest filed an Answer and a Request for Order Compelling TEP to Comply with Commission Regulations Pertaining to the Timely Payment of Bills for Natural Gas Service Pending a Final Resolution on the Merits. On October 26, 2000, a Procedural Order was issued, setting the matter for hearing on January 25, 2001.

4. On November 22, 2000, Southwest Gas Corporation ("Southwest") filed for Commission approval of a Special Gas Procurement Agreement ("procurement agreement") under Special

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Condition Three of Schedule G-30, Optional Gas Service, with Tucson Electric Power Company ("TEP").

5. On December 15, 2000, the Commission suspended this filing until February 18, 2001, to provide Staff with time to analyze the filing.

6. In recent months, Southwest and TEP have held discussions regarding this dispute and as a result of these discussions they have reached a mutually acceptable settlement of their differences.

7. Southwest's filing is a result of a resolution of the dispute between Southwest and TEP regarding the monthly pipeline capacity charges that TEP pays to Southwest under the procurement agreement. Although it is not necessary for Southwest to directly file for Commission approval of the settlement, Southwest felt it was necessary to file for Commission approval of the revised special gas procurement agreement because of the impact on the PGA bank balance of any changes in the capacity charge calculation, as well as the proposed change in the contract to reflect the agreed upon method of calculating the capacity charge.

8. The original procurement agreement contained language indicating that the capacity charge to be paid by TEP to Southwest would be "determined monthly via a calculated methodology agreed to by the Customer and the Utility". At the time, Southwest had indicated to Staff that it had agreed with TEP on the calculation methodology and that the resulting charge would be reflective of current market prices.

9. As with all special gas procurement contracts, the upstream pipeline capacity charges collected from the customer under this contract are credited to the purchased gas adjustor ("PGA") bank balance, thereby benefiting Southwest's ratepayers.

10. If a resolution of the dispute between TEP and Southwest changed the way the pipeline capacity charges for TEP are calculated, that would impact the size of the credits to the PGA bank balance.

11. The dispute between Southwest and TEP involved a number of issues, including how the amount of natural gas supplied to TEP out of different supply basins impacts the capacity charge calculation and whether the capacity charge is capped at 100 percent of the Federal Energy Regulatory Commission ("FERC") approved El Paso firm transportation reservation rates.

12. Southwest's filing amends the capacity charge calculation in the special gas procurement agreement to reflect the terms agreed to in the settlement agreement.

13. Supplies for TEP from the Anadarko and Permian supply basins would be assessed a capacity charge based upon the difference between the Natural Gas Week bid week indices for the Permian basin and the California border. Supplies for TEP from the San Juan Basin would be assessed a capacity charge based upon the difference between the Natural Gas Week bid week indices for the San Juan basin and the California border.

14. Additionally, the capacity charge will be capped at 100 percent of the FERC approved El Paso firm transportation reservation rates.

15. Under the settlement agreement and proposed revision to the special gas procurement agreement, this methodology for calculating the capacity charge would be applied to TEP beginning in October 2000. The settlement agreement contains negotiated numbers for the capacity charge for August and September 2000 and prior to August 2000 TEP agreed to the capacity charges as previously calculated by Southwest.

16. The special gas procurement agreement continues on a year to year basis. Either party is able to terminate the agreement with at least 90 days notice before the anniversary date of this agreement. The agreement covers TEP's generating facilities at Irvington, Demoss-Petrie, and North Loop.

17. TEP's facilities are located in close proximity to an El Paso Natural Gas Company (El Paso) pipeline, and the Irvington facility, which is TEP's main facility included in this agreement, is directly adjacent to El Paso's pipeline. Therefore, TEP can totally bypass Southwest.

18. The procurement agreement includes a commitment by TEP to take all of its natural gas requirements (beyond landfill gas) from Southwest.

19. The specific charges for serving TEP were provided to Staff under a confidentiality agreement. Staff has reviewed the charges included in the proposed procurement agreement and believes that the revenues Southwest receives should cover its cost of serving TEP.

20. However, if conditions change in the gas market it is theoretically possible that Southwest could experience a negative margin on this procurement agreement.

21. Given current circumstances, the proposed capacity charge calculation methodology appears to be an equitable balance between compensating Southwest ratepayers for use of interstate capacity and serving TEP.

22. Additionally, the treatment of past capacity charges, as proposed in the settlement agreement, appears to reflect a reasonable level of compensation to Southwest's core customers for the use of Southwest's interstate capacity by TEP.

23. Staff has recommended approval of this filing.

24. Further, Staff has recommended that any negative margin resulting from this agreement not be recovered from other ratepayers in any future proceeding.

## CONCLUSIONS OF LAW

1. Southwest is an Arizona public service corporation within the meaning of Article XV, Section 2, of the Arizona Constitution.

2. The Commission has jurisdiction over Southwest and over the subject matter of the application.

3. The Commission, having reviewed the application and Staff's Memorandum dated December 21, 2000, concludes that it is in the public interest to approve the filing.

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ORDER

THEREFORE, IT IS ORDERED that the filing be and hereby is approved.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

**BY ORDER OF THE ARIZONA CORPORATION COMMISSION**

CHAIRMAN COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this ________ day of ______________, 2001.

BRIAN C. McNEIL
Executive Secretary

DISSENT: ____________________

DRS:BGG:lhm

SERVICE LIST FOR: Southwest Gas Corporation
DOCKET NO. T- 01551A-00-0963

Ms. Debra S. Jacobson
Manager, State Regulatory Affairs
Southwest Gas Corporation
5241 Spring Mountain Road
Post Office Box 98510
Las Vegas, Nevada 89193-8510

Ms. Lyn Farmer
Chief Counsel
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Ms. Deborah Scott
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007